

**WD74900**

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**IN THE MISSOURI COURT OF APPEALS  
WESTERN DISTRICT**

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**JONATHAN D. EILIAN and  
AMANDA A. EILIAN,**

**Respondents (Petitioners below),**

**vs.**

**DIRECTOR OF REVENUE,  
STATE OF MISSOURI,**

**Appellant (Respondent below).**

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**From the Administrative Hearing Commission of Missouri,  
The Honorable Nimrod T. Chapel, Jr., Commissioner**

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**APPELLANT'S BRIEF**

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**CHRIS KOSTER  
Attorney General**

**JEREMIAH J. MORGAN  
Mo. Bar No. 50387  
Deputy Solicitor General  
P.O. Box 899  
Jefferson City, MO 65102  
(573) 751-1800  
(573) 751-0774 (facsimile)  
[Jeremiah.Morgan@ago.mo.gov](mailto:Jeremiah.Morgan@ago.mo.gov)**

**ATTORNEYS FOR APPELLANT**

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## JURISDICTIONAL STATEMENT

This case came before the Administrative Hearing Commission on a complaint filed by Jonathan Eilian and Amanda Eilian challenging the Director of Revenue's assessment of income taxes and utilization of net operating loss. § 143.121, RSMo (Cum. Supp. 2011).<sup>1/</sup> The question posed in this appeal is whether the Eilians' net operating loss was correctly attributed on their 2006 and 2007 income tax returns. The decision is properly before this Court as the application of existing law.

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<sup>1/</sup> All references to the Missouri Revised Statutes will be to the 2011 Cumulative Supplement, unless otherwise noted.

## STATEMENT OF FACTS

- A. In 2005, Jonathan Eilian claimed a “Net Operating Loss” of \$34,535,832 on his Federal income tax return and elected to carry it forward.**

Jonathan Eilian and Amanda Eilian were, at all relevant times, non-residents of Missouri. Legal File (“LF”) 144, Appendix (“Appdx.”) A2. However, because the Eilians earn income in Missouri, they are required to file income tax returns as non-residents of Missouri. Any taxpayer whose deductions for the year are more than their income for the year on their federal return may have a “Net Operating Loss” (“NOL”). 12 CSR 10-2.710(1).

Jonathan Eilian filed a federal individual income tax return for tax year 2005 in which he claimed a NOL of negative \$34,535,832. LF144, Appdx. A2. He made an election to forego the carryback of the NOL, thereby electing to carry it forward. *Id.*

- B. The Eilians carried forward the \$34,535,832 NOL to their 2006 Federal and Missouri income tax returns.**

The Eilians were married during 2006 and filed a joint 2006 Federal income tax return carrying forward the NOL from 2005. LF76, Appdx. A13. Pursuant to § 143.491, RSMo, the Eilians filed a combined 2006 Missouri income tax return; the Eilians subsequently filed an amended combined Missouri income tax return for reasons not relevant to this appeal. On their amended return, Jonathan Eilian reported a Federal Adjusted Gross Income (“FAGI”) of negative \$6,096,650 – a number

that included the entire \$34,535,832 NOL carried forward from 2005, and Amanda Eilian reported a FAGI of \$102,814, resulting in a combined FAGI of negative \$5,993,836. LF144, Appdx. A2. See chart below:

<b>2006 Amended Individual Income Tax Return</b> <b>As Filed by Jonathan and Amanda Eilian</b>					
<b>Description</b>	<b>Jonathan</b>		<b>Amanda</b>		<b>TOTALS</b>
<b>1. Federal Adjusted Gross Income</b>	-\$6,096,650	+	\$102,814	=	<b>-\$5,993,836</b>
<b>2. Total Additions</b> (Add 2(a) & 2(b), below)	\$35,429,672	+	None	=	<b>\$35,429,672</b>
a. Interest on state & local obligations other than MO source	\$893,840		None		
b. Net Operating Loss	\$34,535,832		None		
<b>3. Total Income</b> (Add lines 1 & 2)	\$29,333,022	+	\$102,814	=	<b>\$29,435,836</b>
<b>4. Total Subtractions</b> (Add 4(a) & 4(b), below)	\$34,538,161	+	None	=	<b>\$34,538,161</b>



a. Interest from exempt federal obligations included in FAGI	\$2,329		None		
b. Net Operating Loss	\$34,535,832		None		
<b>5. MO Adjusted Gross Income</b> (Subtract line 4 from line 3)	-\$5,205,139	+	\$102,814	=	<b>-\$5,102,325</b>

LF 125-27, Appdx. A62-A64.

Jonathan Eilian then filed his 2007 federal individual income tax return claiming “married filing separate” status. In that return, he claimed a carry forward of \$6,117,375 from the 2005 NOL. LF77, Appdx. A14. His 2007 Missouri individual income tax return reported a Federal Adjusted Gross Income of \$40,600,729, which included a 2005 NOL carried forward of \$6,117,375. *Id.*

**C. The Director issued a Final Decision that adjusted the utilization of the 2005 NOL on the Eilians’ 2006 and 2007 Missouri returns.**

On January 21, 2009, the Department of Revenue (“Department”) sent the Eilians a “Notice of Proposed Changes” disallowing the Eilians’ \$34,535,832 NOL subtraction modification (line 4(b) in the table, above) and explaining that the Eilians underpaid on their 2006 Missouri taxes. LF77, Appdx. A14. Following a series of correspondence between the Eilians’ Certified Public Accountant (“CPA”) and the

Department, wherein the Eilians protested the proposed changes, the Department issued a “Notice of Deficiency” to the Eilians on August 12, 2009. LF145, Appdx. A3. The Notice of Deficiency indicated that the Eilians owed the State of Missouri a total of \$47,192 in unpaid taxes, plus interest and additions. *Id.*

On November 2, 2009, the Director of Revenue (“Director”) issued a Final Decision finding that the Notice of Deficiency issued by the Department was correct and finding that the Eilians owed \$47,192 in unpaid taxes, plus interest. LF145, Appdx. A3. The Director found that “Because \$6,117,375 of the carryover to 2006 was also carried over to 2007, an equal amount must be added back to 2006 federal adjusted gross income to reflect the net operating loss deduction exclusively in 2006, and to prevent a cumulative deduction of \$40,653,207 for a total net operating loss of only \$34,535,832.” LF140, Appdx. A77.

<b>2006 Amended Individual Income Tax Return</b>					
<b>As Adjusted by the Director of Revenue’s Final Decision</b>					
<b>Description</b>	<b>Jonathan</b>		<b>Amanda</b>		<b>TOTALS</b>
<b>1. Federal Adjusted Gross Income</b>	-\$6,096,650	+	\$102,814	=	<b>-\$5,993,836</b>
<b>2. Total Additions</b> (Add 2(a) & 2(b), below)	\$7,011,215	+	None	=	<b>\$7,011,215</b>
a. Interest on state & local	\$893,840		None		

obligations other than MO source					
b. Net Operating Loss	\$6,117,375		None		
<b>3. Total Income</b> (Add lines 1 & 2)	\$914,565	+	\$102,814	=	<b>\$1,017,379</b>
<b>4. Total Subtractions</b> (Add 4(a) & 4(b), below)	\$2,329	+	None	=	<b>\$2,329</b>
a. Interest from exempt federal obligations included in FAGI	\$2,329		None		
b. Net Operating Loss	None		None		
<b>5. MO Adjusted Gross Income</b> (Subtract line 4 from line 3)	\$912,236	+	\$102,814	=	<b>\$1,015,050</b>

#### **D. Procedural History**

On November 25, 2009, the Eilians filed a complaint challenging the Director's Final Decision upholding a previously issued Notice of Deficiency that found a deficiency for the Eilians' 2006 income tax. LF1-5 The Director filed her answer and the parties filed a joint stipulation of facts with the AHC. LF74-78 The Eilians filed their brief and reply, and the Director filed proposed findings of fact, conclusions of

law, and a legal brief.

On January 23, 2012, the AHC issued its decision that the Eilians were “not liable for a deficiency on their 2006 individual income tax arising from any failure to pay amounts due from an alleged miscalculation of their net operating loss deduction for 2006.” LF154, Appdx. A12. The Director then filed a Petition for Review with this Court. The question in this case is whether the Eilians’ NOL was properly utilized on the 2006 and 2007 Missouri returns.

**POINT RELIED ON**

**The AHC Erred in Holding that the Eilians are Not Liable for a Deficiency on their 2006 Missouri Taxes, Because the Eilians Inappropriately Utilized the Net Operating Loss Deduction on Their 2006 Missouri Return, In That They Have Received an Impermissible Double Benefit.**

*Brown Group, Inc. v. Administrative Hearing Commission,*

649 S.W.2d 874 (Mo. banc 1983).

§ 143.121, RSMo (2011 Cum. Supp.)

26 U.S.C. § 172(b)(2)

## ARGUMENT

### *Standard of Review*

A decision of the Administrative Hearing Commission (“Commission”) will be affirmed only if: “(1) it is authorized by law; (2) it is supported by competent and substantial evidence on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the General Assembly.” *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 435-36 (Mo. banc 2010); § 621.193.

When the Commission has interpreted the law or the application of facts to law, the review is *de novo*. *State Bd. of Registration for the Healing Arts v. McDonagh*, 123 S.W.3d 146, 152 (Mo. banc 2003); *Zip Mail Servs., Inc. v. Dir. of Revenue*, 16 S.W.3d 588, 590 (Mo. banc 2000). The Commission’s factual determinations “are upheld if supported by ‘substantial evidence upon the whole record.’” *Concord Publ’g House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186, 189 (Mo. banc 1996) (quoting *L & R Egg Co. v. Dir. of Revenue*, 796 S.W.2d 624, 625 (Mo. banc 1990)).

Here, the Commission’s decision is not supported by the law, and should, therefore, be reversed in favor of the Director.

**The AHC Erred in Holding that the Eilians are Not Liable for a Deficiency on their 2006 Missouri Taxes, Because the Eilians Inappropriately Utilized the Net Operating Loss Deduction on Their 2006 Missouri Return, In That They Have Received an Impermissible Double Benefit.**

The starting point for the calculation of a nonresident individuals' Missouri tax liability is to calculate the individual's Missouri Adjusted Gross Income as if he or she was a resident of Missouri. § 143.181.1. Missouri Adjusted Gross Income is calculated by using the taxpayer's Federal Adjusted Gross Income ("FAGI"), and adding in certain amounts that are not taxed on the federal level, but are taxed by Missouri. § 143.121. These amounts, known as addition modifications, are not included in the FAGI but are included in the Missouri Adjusted Gross Income. Section 143.121 also subtracts certain amounts that are taxable at the federal level, but not by Missouri, which are known as subtraction modifications. The sum of the addition and subtraction modifications yields a net modification (which may be positive or negative, depending on the circumstances).<sup>2/</sup>

A taxpayer's FAGI may include deductions for any Net Operating Loss ("NOL")

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<sup>2/</sup> These modifications are calculated on the Form MO-A attached to the individual taxpayer's Form MO-1040, and reported on the Form MO-1040 lines 2 and 4.

carryovers and carrybacks. *See* 26 U.S.C. § 172. Federal law requires that the entire amount of the NOL for any taxable year be carried to the earliest of the taxable years to which such loss may be carried. *See* 26 U.S.C. § 172(b)(2). The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. *See* 26 U.S.C. § 172(b)(2). In other words, when a NOL is not fully absorbed in the first taxable year to which it is carried, the unabsorbed portion may be carried over to the next taxable year.<sup>3/</sup> This process is repeated until the NOL is fully absorbed or the carryover period expires.

Section 26 U.S.C. § 172(b)(2) provides guidance concerning how much of a NOL is absorbed in the taxable year to which it is carried and how much, if any, remains to be carried over to the next taxable year. In order to resolve these matters, the statute requires that the taxpayer compute a “modified” taxable income of the carryover year. *See* Treas. Reg. § 1.172-5. Only so much of the NOL that exceeds the modified taxable income of each carryover year may itself be carried over to the next taxable year. *See* 26 U.S.C. § 172(d). A taxpayer may elect to relinquish the carryback period with respect to the loss sustained in a given year in favor of carrying forward the NOL. If

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<sup>3/</sup> The term “absorbed” is used in the treasury regulations and instructions to describe the portion of the NOL amount that has been offset against modified taxable income. Any amount not absorbed is available to carry over to the next tax year.



the taxpayer so elects, the entire NOL is carried forward to the earliest year in the carryover period. The Eilians elected to carry forward the loss, and that election is irrevocable.

In its holding, the Commission states that “Jonathan and Amanda Eilian are not liable for a deficiency on their 2006 individual income tax arising from any failure to pay amounts from an alleged miscalculation of their net operating loss deduction for 2006.” Final Decision, p. 1. Neither party disputes the fact that the Eilians had a federal NOL carryover from 2005 to 2006. Under federal law, the entire amount of the NOL, \$34,535,832 is carried to 2006. *See* Treas. Reg. § 1.172-4(b). Neither party disputes the fact that the Eilians carried forward a \$34,535,832 NOL from 2005 to 2006. The issue in dispute is whether the Eilians must make an adjustment to line one of the 2006 Missouri return to prevent the Eilians from receiving an impermissible double benefit for Missouri purposes. The Commission’s Final Decision failed to address this issue. When the law is properly applied to the facts, it is clear that the Director’s position is correct.

**A. Missouri and Federal Tax Laws Work Together to Determine  
the Appropriate Application of a Net Operating Loss.**

Missouri’s statutory scheme, in computing what is taxable at the Missouri level, “piggybacks” the federal scheme. Instead of separately computing items of income and deductions for Missouri, an individual begins with federal adjusted gross income (“FAGI”) and federal itemized deductions. If the taxpayer chooses to itemize on the

federal level, the taxpayer may elect to deduct Missouri Itemized deductions. Otherwise, a Missouri standard deduction is used. Under this system, the federal effects of items of income and deduction “flow through” to Missouri.

FAGI, however, is merely the starting point for computing Missouri taxable income. Section 143.011 imposes a tax on the Missouri taxable income of every resident.<sup>4/</sup> Section 143.111 states that the Missouri taxable income of a resident shall be the resident’s Missouri adjusted gross income (“MAGI”) less either Missouri standard or itemized deductions, Missouri personal and dependency exemptions, the deduction for federal income taxes, and the deduction for self-employed health insurance costs. When calculating itemized deductions, Missouri starts with federal itemized deductions, but makes adjustments for items that are deductions under federal law but are not allowed by Missouri. § 143.141.

Because Missouri begins the computation of MAGI with FAGI, the effect of an

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<sup>4/</sup> The Eilians are not residents, but § 143.041 imposes a tax upon nonresidents which “bears the same ratio to the tax applicable to the individual if he would have been a resident as (A) his Missouri nonresident adjusted gross income as determined under section 143.181 (Missouri adjusted gross income derived from sources in this state) bears to (B) his Missouri adjusted gross income derived from all sources.” Therefore the computations begin by determining the tax as if the Eilians were residents.

NOL on the federal level must be examined because the result “flows through” to Missouri. On a federal return, an individual begins by computing FAGI. Included in FAGI is the entire amount of the NOL carryover, which is equal to the aggregate of (1) the NOL carryovers to such year, plus (2) the NOL carrybacks to such year. *See* 26 U.S.C. § 172. But when the NOL exceeds the taxable income for a year, the taxpayer must determine how much of the NOL is absorbed in that year and how much may be carried over to the next taxable year. This is done by computing a “modified taxable income.” Treas. Reg. § 1.172-5. Any NOL exceeding the modified taxable income for the first carryover year is carried to the next year. The modified taxable income, which includes itemized deductions, is offset by the NOL and the left-over portion of the NOL is the amount carried to the next taxable year.

Internal Revenue Service Publication 536 covers the procedures for net operating losses for individuals for tax year 2006. *See* <http://www.irs.gov/pub/irs-prior/p536--2006.pdf>. It includes a worksheet for calculating modified taxable income in order to determine how much of a NOL is absorbed and how much remains for carryover to the next year. For tax year 2006, the Eilians’ modified taxable income was \$28,418,457; therefore, \$28,418,457 of the 2005 NOL was absorbed in 2006, leaving only \$6,117,375 of the 2005 NOL to be carried over to 2007. This is also illustrated on the face of the Eilians’ federal Form 1040. LF99-LF104. The Eilians’ FAGI as reported on line 37 was negative \$5,993,836. After subtracting itemized deductions of \$123,539 from FAGI, the Eilians reported negative \$6,117,375 on line 41.

LF102-LF103. Conceptually, this means the Eilians did not have to use their itemized deductions against income in 2006 and instead that amount essentially becomes part of the Eilians' NOL carryover to the next taxable year.

The Eilians reported FAGI of negative \$5,993,836 on line 1 of the Form MO-1040. This amount reflected the "flow through" to the Missouri return of the federal tax consequences of all the items of income and deductions used in computing the Eilians' FAGI. The Eilians then reported total addition modifications of \$35,429,672<sup>5/</sup> and total subtraction modifications of \$34,538,161<sup>6/</sup> for a positive net modification of \$891,511. So, the Eilians should have reported \$891,511 of income that was not taxed at the federal level, but is taxable in Missouri. However, because the Eilians reported a negative FAGI (which resulted only because of the inclusion of the entire NOL carryover from 2005), part of their NOL offset the Missouri positive net modifications. Thus, the Eilians used \$28,418,457 of their 2005 NOL at the federal level and an additional \$891,511 at the Missouri level, for a total of \$29,309,968 offset against income items.

The Eilians also received an additional offset due to how they computed Missouri

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<sup>5/</sup> The Eilians reported \$893,840 in interest on non-Missouri source state and local obligations, and \$34,535,832 as NOL for a total of \$35,429,672.

<sup>6/</sup> The Eilians reported \$2,329 in interest from exempt federal obligations and \$34,535,832 as NOL for a total of \$34,538,161.

itemized deductions. On the Form MO-1040A, the Eilians reported federal itemized deductions of \$123,539.<sup>7/</sup> Missouri allows certain itemized deductions not allowed at the federal level and disallows certain deductions that are allowed at the federal level. § 143.141. The Eilains reported the proper adjustments to federal itemized deductions, but as a result of starting with an amount that was not actually used to offset income at the federal level, the Eilians deducted \$123,539 more at the Missouri level.

In total, for 2006, the Eilians reduced their income by \$28,418,457 at the federal level. For Missouri, the Eilians reduced their income by the same \$28,418,457, offset \$891,511 in taxable income taxable only to Missouri, and deducted \$123,539 more than they deducted on the federal return. In 2007, Jonathan Eilian reported FAGI of \$40,600,729. This included a NOL deduction of \$6,117,375.<sup>8/</sup> As Missouri starts with FAGI, Jonathan Eilian also reduced his 2007 income taxable in Missouri by \$6,117,375. Thus between 2006 and 2007, the Eilians used \$35,429,672 in NOL to reduce taxable income for federal purposes (\$28,418,457 for 2006 and \$6,117,375 for 2007), but used \$36,444,722 for Missouri purposes (the same \$35,429,672, plus an

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<sup>7/</sup> On the federal return, this amount was not actually deducted against income but “converted” into part of the NOL carry over to 2007.

<sup>8/</sup> In 2007, Jonathan Eilian filed married filing separate and claimed the entire amount of the remaining NOL.

additional \$891,511 to offset the 2006 net modifications and \$123,539 in additional itemized deductions). As reported by the Eilians, the NOL deductions resulted in \$1,015,050 more in benefits for Missouri purposes than for federal purposes.

**B. Missouri Law Prohibits a Taxpayer from Benefitting Twice  
From the Same Loss.**

The issue of this impermissible multiple benefit arises because the 2006 FAGI is calculated by including the entire amount of the NOL carried over from 2005, regardless of the amount of NOL actually absorbed and utilized in 2006. Because a different (smaller) amount of NOL was ultimately used on this return to compute taxable income for federal purposes, an adjustment to the FAGI used in the Missouri computation is warranted. Such an adjustment would reconcile the difference in the NOL amount included in 2006 FAGI with the NOL amount actually absorbed in 2006. This adjustment could be done in many ways; however, the Director chooses to make an adjustment to line 1 of the Missouri return to prevent the multiple benefits that would otherwise result from the NOL.

The Missouri Supreme Court examined this issue in *Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983). In the decision, the Court prohibited a taxpayer from benefitting twice from the same loss. The taxpayer was a corporation that incurred a loss in 1975 and reported that negative amount as its 1975 federal taxable income for Missouri purposes, but it was also entitled by federal law to carry back that loss to 1972. The Court recognized that 26

U.S.C. § 172 allows a taxpayer to offset income and stated:

This statutory scheme permits a taxpayer to receive a Missouri benefit from the federal net operating loss provisions. Therefore, if a taxpayer were allowed to include a negative amount on line 1 of the Missouri return the result would be multiple benefits arising from a single loss. For example, the loss would offset positive modifications prescribed by § 143.431.2 for the computation of Missouri taxable income and still be available to reduce federal taxable income in prior years.

*Id.* at 876-77.

In *Brown Group*, the focus was on federal taxable income, because that is the starting point for computing Missouri tax for a corporation. For an individual, however, the computation of Missouri tax begins with FAGI. So, for individuals, the application of the *Brown Group* holding should focus on FAGI, and the question should be whether the inclusion of a negative amount on line 1 (*i.e.*, FAGI for an individual)

should result in multiple benefits arising from a single loss.<sup>9/</sup>

Under the Eilians' computations, also adopted by the Commission, the use of the negative FAGI without adjustment allows the Eilians to offset the Missouri positive net modifications, as well as reducing their federal taxable income in the future.

This is illustrated by the following computations:

<b>2006 MO-1040 – as filed by the Eilians</b>			
	Jonathan Eilian	Amanda Eilian	Combined
Federal adjusted gross income	(\$6,096,650)	\$102,814	(\$5,993,836)
Addition modifications	\$35,429,672	\$0	\$35,429,672
Subtraction modifications	<u>(\$34,538,161)</u>	<u>\$0</u>	<u>(\$34,538,161)</u>
<b>Missouri adjusted gross income</b>	<b>(\$5,205,139)</b>	<b>\$102,814</b>	<b>(\$5,102,325)</b>
Spousal percentage	100%	0%	100%
Missouri standard/itemized			(\$104,928)

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<sup>9/</sup> The Director acknowledges that *Brown Group* focused on the loss year, not a carryover year, but the rationale is the same. (The relevant question is how to treat a negative amount of income reported on the first line of a return.). The Director also notes that the *Brown Group* taxpayer was unable to actually use the carryback to 1972 for Missouri purposes, but the Court did not find that relevant to its analysis.



deduction			
Federal tax deduction			(\$10,000)*
Personal exemption			(\$4,200)
Dependent exemption			\$0
Total deductions			(\$119,128)
<b>Missouri taxable income</b>	<b>(\$5,221,453)</b>	<b>\$0</b>	<b>(\$5,221,453)</b>
Missouri income tax	\$0	\$0	\$0
Resident credit			\$0
Nonresident income percentage	-17%	0%	-
Tax balance due	\$0	\$0	\$0
Estimated payments			\$0**
<b>Tax due</b>			<b>\$0</b>
* Zero federal income tax, \$769,664 other tax			
** Originally \$573 paid, but all of it was previously refunded			
<b>Addition modifications</b>			
State/local muni bond interest	\$893,840		
NOL adjustment	<u>\$34,535,832</u>		
<b>Total</b>	<b>\$35,429,672</b>	<b>\$0</b>	
<b>Subtraction modifications</b>			

Exempt federal interest	(\$2,329)		
NOL adjustment	(\$34,535,832)		
<b>Total</b>	(\$34,538,161)	\$0	
<b>Itemized deductions</b>			
Federal itemized deductions	(\$123,539)		
FICA – primary	\$0		
FICA - secondary	(\$7,327)		
SE tax	<u>(\$22,965)</u>		
Subtotal	(\$153,831)		
State and local tax	\$52,740		
Local earnings tax	<u>(\$3,837)</u>		
Net state income tax deduction	\$48,903		
Missouri itemized deductions	(\$104,928)		
<b>MO-NRI</b>			
Total Missouri income	\$896,789	\$0	
Missouri adjusted gross income	(\$5,205,139)	\$102,814	
Missouri income percentage	-17%	0%	

These computations also show how the Eilians received multiple deductions of

the \$123,539 federal itemized deduction amount. The Eilians began their 2006 Missouri itemized deductions calculation with federal itemized deductions of \$123,539, receiving a Missouri benefit for that amount, even though in 2007, Jonathan Eilian reduced his federal taxable income (and his FAGI) by \$6,117,375, which “flowed through” to Missouri as shown:

<b>Jonathan Eilian’s 2007 MO-1040 as filed</b>	
Federal adjusted gross income	\$40,600,729 <sup>10/</sup>
Addition modifications	\$10,914,727
Subtraction modifications	<u>(\$6,262,316)</u>
<b>Missouri adjusted gross income</b>	<b>\$45,253,140</b>
Spousal percentage	100%
Missouri itemized deduction	(\$11,517,495)
Federal tax deduction	(\$5,000)
Personal exemption	(\$2,100)
Dependent exemption	<u>\$0</u>
Total deductions	(\$11,524,595)
<b>Missouri taxable income</b>	<b>\$33,728,545</b>
Missouri income tax	\$2,023,488
Nonresident income percentage	<u>3%</u>

<sup>10/</sup> FAGI of \$40,600,729 includes the NOL deduction of \$6,117,375.

Tax balance due	\$60,704.64
Estimated payments	(\$70,719)
Previous refunds	<u>\$9,626</u>
Refund transferred to 2008	(\$388)
*\$8,969,831 income tax, \$8,314 other tax	
<b>Addition modifications</b>	
State and local muni bond interest	\$4,797,352
NOL adjustment	\$6,117,375
<b>Total</b>	\$10,914,727
<b>Subtraction modifications</b>	
Exempt federal interest	(\$144,941)
NOL adjustment	(\$6,117,375)
<b>Total</b>	(\$6,262,316)
<b>Itemized deductions</b>	
Federal itemized deductions	(\$14,041,325)
FICA – primary	\$0
FICA - secondary	\$0

SE tax	<u>(\$20,185)</u>
Subtotal	(\$14,061,510)
Net state income tax deduction	<u>\$2,544,015</u>
Missouri itemized deductions	(\$11,517,495)
<b>MO-NRI</b>	
Total Missouri income	\$1,396,726
Missouri adjusted gross income	\$45,253,140
Missouri income percentage	3%

Since the amount of the NOL carryover from 2006 to 2007 included the \$123,539 of federal itemized deductions, Jonathan Eilian received a second Missouri benefit for that amount.

The overall result is that the Eilians offset Missouri positive net modifications in 2006 by an amount that they also received in 2007. They further offset Missouri income by deductions not used in 2006, but allowed to be used in 2007. There are no Missouri statutes that allow these offsets. Under *Brown Group*, when the Eilians incur a federal loss, the “sole recourse is to § 172. That is the only reasonable consequence of construing § 63 in harmony with § 172. Any other holding would subject a single loss to multiple use in Missouri without the requisite statutory authority.” *Id.* at 877.

An adjustment to the Eilians' return must be made to prevent these offsets. The Director properly made an adjustment to the 2006 return to correct the offsets. On the Eilians' 2006 Missouri return, an adjustment of \$6,117,375 should be made, as illustrated by the following:

<b>2006 MO-1040</b>			
	Jonathan Eilian	Amanda Eilian	Combined
Federal adjusted gross income	(\$6,096,650)	\$102,814	(\$5,993,836)
Addition modifications	\$7,011,215	\$0	\$7,011,215
Subtraction modifications	<u>(\$2,329)</u>	<u>\$0</u>	<u>(\$2,329)</u>
<b>Missouri adjusted gross income</b>	<b>\$912,236</b>	<b>\$102,814</b>	<b>\$1,015,050</b>
Spousal percentage	90%	10%	100%
Missouri standard/itemized deduction			(\$104,928)
Federal tax deduction			(\$10,000)*
Personal exemption			(\$4,200)
Dependent exemption			\$0
Total deductions			(\$119,128)
<b>Missouri taxable income</b>	<b>\$806,329.80</b>	<b>\$89,592.20</b>	<b>\$895,922</b>
Missouri income tax	\$48,155	\$5,151	\$53,306
Resident credit			\$0

Nonresident income percentage	98%	0%	-
Tax balance due	\$47,191.90	\$0	\$47,191.90
Estimated payments			\$0**
<b>Tax due</b>			<b>\$47,192</b>
* Zero federal income tax, \$769,664 other tax			
** Originally \$573 paid, but all of it was previously refunded			
<b>Addition modifications</b>			
State/local muni bond interest	\$893,840		
NOL adjustment	<u>\$6,117,375</u>		
<b>Total</b>	<b>\$7,011,215</b>	<b>\$0</b>	
<b>Subtraction modifications</b>			
Exempt federal interest	(\$2,329)		
<b>Total</b>	<b>(\$2,329)</b>	<b>\$0</b>	
<b>Itemized deductions</b>			
Federal itemized deductions	(\$123,539)		
FICA – primary	\$0		
FICA - secondary	(\$7,327)		
SE tax	<u>(\$22,965)</u>		

Subtotal	(\$153,831)		
State and local tax	\$52,740		
Local earnings tax	<u>(\$3,837)</u>		
Net state income tax deduction	\$48,903		
Missouri itemized deductions	(\$104,928)		
<b>MO-NRI</b>			
Total Missouri income	\$896,789	\$0	
Missouri adjusted gross income	\$912,236	\$102,814	
Missouri income percentage	98%	0%	

The FAGI represents the Eilians' federal adjusted gross income of negative \$5,993,836, adjusted as required by *Brown Group*. By increasing FAGI to \$6,117,375, for 2006, the Eilians still receive the benefit of the NOL deduction against federal taxable income, and they are taxed on the Missouri positive net modifications. The itemized deductions, while allowed, are also mitigated by the adjustment.

On his 2007 return, which the Director accepted as filed, Jonathan Eilian still receives the benefit of the full NOL carryover of \$6,117,375, including the 2006 \$123,539 itemized deductions, against his federal taxable income. The Eilians, however, no longer receive multiple benefits from the same NOL. Similar to *Brown Group*, the adjustment prevents the Eilians from taking a NOL deduction greater than



authorized by Missouri statutes. In reaching its determination that the Eilians owe no deficiency for 2006, the Commission failed to examine the relevant evidence and address the application of law upon the adjustments the Director made.

### CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the Administrative Hearing Commission in favor of the Director of Revenue and against Jonathan D. and Amanda A. Eilian.

Respectfully submitted,

**CHRIS KOSTER**  
Attorney General

/s/ Jeremiah J. Morgan  
Jeremiah J. Morgan  
Mo. Bar No. 50587  
Deputy Solicitor General  
P.O. Box 899  
Jefferson City, MO 65102  
(573) 751-1800  
(573) 751-0774 (facsimile)  
[Jeremiah.Morgan@ago.mo.gov](mailto:Jeremiah.Morgan@ago.mo.gov)

**ATTORNEYS FOR APPELLANT**

## CERTIFICATION OF SERVICE AND COMPLIANCE

I hereby certify that on the 16<sup>th</sup> day of July, 2012, the foregoing brief was filed electronically via Missouri CaseNet and served electronically to:

J. Kent Lowry  
Armstrong Teasdale, LLP  
3405 West Truman Blvd., Suite 210  
Jefferson City, MO 65109

*Attorney for Jonathan and Amanda Eilian*

I further certify that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 4,875 words.

/s/ Jeremiah J. Morgan  
Jeremiah J. Morgan